

**THE PRODUCTIVITY COMMISSION
INQUIRY INTO ASSISTANCE TO THE
AUTOMOTIVE INDUSTRY**

**THE VICTORIAN GOVERNMENT POLICY
POSITION**

AUGUST 2002

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Executive Summary

- 1.1 The automotive industry is without doubt one of the most strategically important industries that currently operates in Australia. The Australian automotive industry has undergone a radical transformation over the past 20 years. Embracing change, forging new export markets, leading innovation and encouraging development in manufacturing are all attributes that have marked this transformation.
 - 1.2 The automotive industry plays an important role in the Victorian economy, directly employing more than 27,000 people with a significant proportion of that employment in regional areas. Victoria is the 'engine room' of the Australian automotive industry contributing 51 percent of the industry's total national employment, 70 percent of Australia's component manufacturers and 54 percent of total national exports.
 - 1.3 The automotive industry is strategic, characterised by vast and deep linkages that exist regionally, nationally and globally. These linkages foster integration of tier 1,2 and 3 manufacturers in the manufacturing supply chain creating export opportunities and innovation in Australian manufacturing. The linkages facilitate important spill-overs in skills development, linkages to the global networks, expenditure on and performance of R&D, the dissemination of world's best practice manufacturing methods and technologies, and closer linkages to the services sector, building Australia's reputation as an exporter of complex manufactured products. Most importantly however, the automotive industry embodies the unique characteristics of innovation and dynamism for which there is fierce international competition.
 - 1.4 A number of factors have been driving the current success of the automotive industry.
 - Australian vehicle and component producers have been instrumental in promoting and expanding exports. Australian exports have continued to increase from \$2.72 billion in 1997 to \$4.249 billion in 2001.
 - The Australian automotive industry invested \$420 million in R&D investment for the period 1999/2000. 71 percent of the total national R&D expenditure was in Victoria making the automotive industry the highest business R&D investor in the State.
 - The quality of Australian vehicle production has continued to improve with a decline of 57 percent in sample average faults recorded from 1996 to 2000.
 - The automotive industry has fostered an improving industrial relations record with the number of days lost per thousand in the metal, machinery and equipment manufacturing sector declining by 52.1 percent over the period of 1986 – 2001.
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1.5 This performance is attributable to a number of factors that the Victorian Government believes are critical to the continued success of the automotive industry. These factors include:

- An environment that fosters innovation and knowledge based industry;
- A predictable, stable investment environment to encourage further growth contributing favourably to the success of manufacturing in Australia;
- Improved export access to broaden Australia's export base and ensure the future viability of the industry as due to the limited nature of future domestic sales;
- Increased investment in R&D;
- Ongoing improvement in labor productivity fostered through a collaborative approach; and
- An industry support package which is internationally competitive because other national governments offer a broad range of support to attract, maintain and grow their automotive industry including tariff levels, grants, tax concessions and local content preference schemes.

1.6 The Victorian Government is pleased that the Position Paper recently released by the Productivity Commission acknowledges many of these factors. However, the Victorian Government has some concerns with its policy conclusions:

- Despite the Productivity Commission's modelling concluding that there would be negligible benefit to the Australian economy, it recommends progressive withdrawal of industry support.
 - It does not identify the policies necessary to encourage a competitive innovation based industry.
 - It asserts a unilateral decrease in tariffs and industry support will bring net benefits to the automotive industry and the Australian economy regardless as to whether foreign markets liberalise or further tighten their markets.
 - It underestimates the importance and uniqueness in Australia of the spillover economic benefits associated with the activities of the Australian automotive industry.
 - It inadequately addresses the economic impact on regional Australia.
 - It presents an unduly negative view of the industrial relations environment in the industry and makes some preliminary findings which do not appear to be based on appropriate research or evidence.
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1.7 The Victorian Government strongly advocates an industry assistance package that ensures support for these critical success factors. In so doing, we recommend that the Productivity Commission emphasises policy settings that:

- Foster a stable investment environment through certainty and a commitment to the industry;
 - Provide long term certainty on tariff levels that consider the progress of Australia's international competitors in the reduction of tariff barriers;
 - Improve export market access through multilateral and bilateral negotiations;
 - Maintain an ACIS style industry assistance package to support innovation and R&D; and
 - Encourage a collaborative workplace environment.
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Introduction

The Victorian Government's commitment to the automotive industry

- 2.1 The future of Australian manufacturing, and indeed Australia's aspirations to become an innovative, knowledge based economy, depends heavily on the future growth of the automotive industry. This industry is the largest advanced manufacturing sector in Australia, and is concentrated in Victoria. This document presents the Victorian Government policy position on the future of Australia's automotive industry and directly responds to the Position Paper released by the Productivity Commission.
- 2.2 The Victorian Government is committed to making Victoria a more innovative State. In the *Growing Victoria Together* policy statement, the Victorian Government recognises and encourages innovation as a key to thriving industries and high quality jobs.¹ The Government's policies and programs for the development of the 'Innovative State' focus on actions to stimulate innovation by encouraging the creation of an economy that:
- ***has an educated and highly skilled workforce*** – supported by a high quality, flexible education and training system that is fundamental to economic growth and the creation of high value jobs.
 - ***is a leader in knowledge creation and innovation*** – built on world class foundations in science, technology and creativity.
 - ***is integrated and networked locally*** – taking ideas to market through clusters and networks and the advanced use of information and communications technologies.
 - ***has high levels of enterprise formation and business growth*** – a spirit of entrepreneurship, with businesses investing for the future in skills, R&D, production equipment and processes which are able to respond quickly to changing customer needs
 - ***is internationally integrated*** – businesses and a State that are international in outlook – in trade, investment, knowledge creation and cultural diversity.
 - ***has a business environment and infrastructure base that facilitates business success*** – infrastructure and services that are rated among the world's best.

¹ See Attached Growing Victoria Together Policy Statement

- 2.3 The Australian automotive industry exhibits all of the attributes that characterise an innovation economy. The industry is therefore a vital contributor to the future of Victoria as an innovative State and an important catalyst for transformation within the broader economy. The strategic role that the industry plays within regional, national and global innovation systems attests to why there is such fierce global competition to attract and retain automotive industry investment.

The strategic importance of the automotive industry

- 2.4 The Productivity Commission notes that the automotive industry is characterised by extensive and deep linkages to the wider economy. It is both a purchaser of high volumes of manufactured goods and a leading user of advanced technologies associated with design and engineering, production, materials handling, inspection and testing processes and communications.
- 2.5 For example, the tooling segment of the precision engineering industry has linkages with the automotive industry to manufacture and supply a range of vehicle components. Approximately 65 per cent of output is directed to either auto assemblers or their tier 1 suppliers. The industry is becoming increasingly concentrated in Victoria and currently employs 7,000 people. The State's share of total national output for the industry is currently 45 percent and increasing, while Victoria's share of precision engineering exports is 60 percent.²
- 2.6 The automotive market is also the second most important market for Victoria's metal fabrication industry with 14 percent of total output directed to vehicle producers and their direct suppliers. It is estimated that the metal fabrication industry employs 4,200 people directly servicing the automotive industry.³ These strong industry linkages create export opportunities for supplier industries and broaden the skills and innovation capabilities base of the economy.
- 2.7 Not only is the automotive industry a major investor in R&D in its own right, it also acts as an early adopter of manufacturing technologies such as robotics and computer aided design and of important production and supply chain management processes. The world's best practices that the industry has adopted in areas such as quality control systems, logistics, workforce skills development and value chain management are then able to be disseminated through the wider Australian economy creating important spill-over benefits.
- 2.8 The Victorian Government's Manufacturing Industry Consultative Council recently commissioned a report investigating the importance of the automotive industry for the Victorian economy. This report summarised the strategic importance of advanced manufacturing as follows:

² The Victorian Precision Engineering Industry Strategic Plan June, 2002.

³ The Victorian Metal Fabrication Industry Strategic Plan June, 2002.

Strategic manufacturing industries produce complex and elaborately transformed products which are skill, knowledge and innovation intensive. These industries are strategic because:

- *they have strong upstream and downstream linkages with other industries in the economy;*
- *they are industries which, in the main, transfer leading edge technologies to the local economy; and*
- *they are the industries that develop the skills, work organisation arrangements and new management techniques which through labour turnover, supply chain networks, etc. spillover to the rest of the economy, thus transferring both technology and knowledge to other important industries including technical services industries.⁴*

2.9 The spillover benefits to the economy that the presence of a globally orientated, knowledge intensive, service enhanced advanced manufacturing industry brings to Australia, make the automotive industry one of the most strategically important industries that currently operates in Australia.

The scale of the automotive industry

2.10 The sheer scale of the automotive industry makes it an important industry for Australia generally but Victoria in particular. Victoria is the ‘engine room’ of the Australian automotive industry because:

- The automotive industry including the design, manufacture and assembly of motor vehicles and components is Victoria’s largest manufacturing industry, contributing about 2 per cent of Victorian Gross State Product in 1999-2000. This represents a total value added of almost \$2.29 billion in 1999-2000 equating to 59 per cent of the industry’s national total of approximately \$3.88 billion.
- It directly employs more than 27,000 people in Victoria, 51 percent of the industry’s total national employment, with a significant proportion of that employment located in regional Victoria.
- In 2002 Australian automotive exports are set to exceed \$5 billion, making it one of Australia’s largest exporter, exceeding such traditional export sectors as grain and wool.
- The Victorian automotive industry incorporates 70 per cent of Australia’s component manufacturers and currently accounts for 54 per cent of total national automotive exports.

⁴ The National Institute of Economic and Industry Research, *Motor vehicle industry assistance: Implications for the industry and the Victorian economy*, July 2002.

- In 1999-2000 Business Expenditure on R&D (BERD) in the Victorian automotive industry amounted to nearly \$299 million or 71 per cent of \$420 million total national automotive industry R&D expenditure. The BERD performance is testimony to the industry's commitment to increasing technology and innovative solutions for future production.
- 2.11 While the Victorian Government acknowledges that, based on the assumptions modelled by the Productivity Commission, a fall in tariffs from 10 –5 percent could generate some small benefits to the national economy. It clearly notes that this modelling reveals significant adjustment costs of a tariff reduction in areas where the industry has a high concentration of employment and economic activity.
- 2.12 These significant adjustment costs are further evidenced in the modelling conducted by the Victorian Department of Treasury and Finance.⁵ Their State specific modelling, based on the same simple assumptions as the Productivity Commission,⁶ estimates that while a fall in tariffs to 5 percent would result in a rise in economic welfare nationally of \$1.50 per person per annum, Victoria would suffer welfare losses of \$4 per person per annum, and up to 6,500 jobs.
- 2.13 The Victorian Government is of the view that alternative modelling based on more realistic assumptions than those employed by the Productivity Commission, would reveal that the negative impacts predicted for Victoria from a further tariff reduction, would also extend to the national economy. Additional modelling work is being undertaken with revised assumptions by the Victorian Government which will be presented in a report to Federal Ministers.

⁵ The analysis was conducted using the Victorian Treasury version of the MMRF-GREEN model of the Australian economy. The MMRF-GREEN model is a multi-sectoral, multi-state, general equilibrium model of the Australian economy, which treats the state economies individually.

⁶ For example, the modelling assumes no changes in employment.

Success story to date

Elements Underpinning the Industry's Current Success

3.1 Australia's automotive industry is a clear success story characterised by:

- Increased exports
- Improving quality
- Continuing research and development
- Skills development and investment in people through training
- Improving industrial relations environment

Export Performance

3.2 The automotive industry has sustained commendable levels of performance in recent years during which time nominal tariff levels have been reduced from 22.5 percent in 1997 to 15 percent in 2000, and substantial changes made to assistance schemes. Exports have continued to increase from \$2.72 billion in 1997 to \$4.249 billion in 2001 and are rapidly approaching the 2006 target of \$6 billion the industry set itself in 1997. Export sales of component manufacturers increased by 63 percent over the same period. Much of the growth of exports is attributable to marketing opportunities created in the Middle East and the US.

3.3 Similarly, exports of automotive components increased from \$181 million in 1996 to \$486 million in 2001. Exports to Indonesia – which has an infant automotive manufacturing industry to protect – have grown six-fold over the same period to \$98 million in 2001. Improved market access to world markets, particularly Asia, will facilitate future growth in sales to the region.

Improvements in Quality

3.4 Quality performance of locally manufactured passenger motor vehicles has increased significantly since 1996. Sample average faults per vehicle for medium vehicles fell from 1.4 in 1996 to 0.8 in 2000. A similar trend also occurred in large car manufacturing with sample average faults falling from 1.8 in 1996 to 1.1 in 2000.⁷

A Leader in Innovation, Design and R&D

3.5 Investment in R&D is fundamental to manufacturers' and suppliers' ability to drive the development of innovative products, new technologies and alternative design concepts. The Victorian Government is mindful of the technological advances required for a prosperous future in automotive production. Notwithstanding environmental and safety advances, competition is fierce in advancing vehicle design and the integration of new computer technology.

3.6 The Australian automotive industry is widely recognised for its innovation of high quality products and services and commitment to increasing technology for future

⁷ The faults data recorded is derived from responses to surveys of private new car buyers in the first 3 months of vehicle ownership. Source: A C Neilson, 2000 New Car Buyer Survey.

production. The automotive industry has established significant linkages and research partnerships with universities and researchers and participates in a number of Cooperative Research Centres to progress innovation in the industry. These links are vital if manufacturers and suppliers are to keep pace with the increasing demands of new technologies and products.

Skills Development and Investing in People through Training

- 3.7 Today's automotive industry is characterised by organisations that actively encourage learning and skills development through structured programs. This is apparent in the industry's significant investment in training and skills development, its ability to attract skilled professionals and rising productivity levels across the industry.
- 3.8 Spending on education and training in the automotive industry is well above the rate in industry generally with the average in excess of 4 percent of total wages. According to the Department of Industry, Tourism and Resources, industry productivity levels, as measured by vehicles produced per employee, rose dramatically during the 1990s. Vehicles produced per employee have increased from 10.8 vehicles per employee in 1991 to 16.3 vehicles per employee in 1999.

An Improving Industrial Relations Record

- 3.9 Anecdotal information from a number of vehicle manufacturers suggests that within their global corporations, their Australian manufacturing facilities are regarded as having good productivity and workforce flexibility standards, given their relatively low production volumes by international benchmarks.
- 3.10 There has been a dramatic and sustained decline in the level of industrial disputation in the automotive industry over the last fifteen years. The downward trend is evident across all industries and for manufacturing generally, but is even more pronounced in the metal, machinery and equipment manufacturing (MM&E) sub-group which covers the automotive industry.
- 3.11 Over the period 1986-2001, total working days lost due to industrial disputes nationally declined by 52.1 percent in the MM&E subgroup and 53.7 percent in Victoria. There was also a substantial decline in the indicator of working days lost per thousand employees in the MM&E, which dropped 42.1 percent nationally and 58.7 percent in Victoria in this period. The number of disputes recorded per year declined nationally by 70.7 percent and in Victoria by 54.1 percent.
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Factors critical to ongoing success

Key factors

4.1 Much of the industry's future success will rest on its own endeavors to further innovate, improve productivity, quality and product desirability. The Victorian Government also acknowledges that there are a number of policy issues that play a critical role in the continued success of the automotive industry. These include:

- an environment that fosters continued enhancement in the industry's innovation and skills capabilities;
- a predictable, stable, internationally competitive investment environment that encourages further capital expenditure by the industry and sustains a critical mass;
- improved market access to broaden Australia's export base and increase the industry's volume growth; and
- a constructive, collaborative labour market approach that fosters continued labour productivity improvement.

An environment that fosters innovation and skills capabilities

4.2 Appropriate levels of funding and policy settings are essential to encourage and foster continued increases in innovation and skills capabilities. This is an area where the Victorian Government is taking an active and decisive role, through initiatives such as the \$310 million Science and Technology Infrastructure fund and its recent announcement that it will be investing a further \$9.2 million over the next two years to further boost Victoria's design capabilities, particularly in the areas of aerospace and automotive design.

4.3 The current level of generally available Commonwealth support for R&D is inadequate to build its knowledge-intensive industries. Notwithstanding the recent rise in BERD, Australia's R&D performance remains well below most of its OECD competitors. The Victorian Government urges the Federal Government to play an active role in encouraging greater R&D.

A stable investment environment sustaining a critical mass

4.4 A stable environment is essential to the long term investment strategies of the Australian automotive companies, in production capacities as well as R&D investments.

4.5 A stable environment is also critical to the attainment and maintenance of critical mass in the automotive industry. Through their submissions to the Productivity Inquiry the automotive industry has asserted that a minimum production of between 330,000 to 350,000 units a year is required to produce the critical mass to ensure a viable Australian automotive industry. Currently, exports make up

around 120,000 of all vehicles produced with the remainder supplying the domestic market. Given this, and coupled with the fact that the potential for large growth in domestic sales is limited, significant growth in exports has become even more necessary to the industry.

- 4.6 If a high exporting producer were to cease production as a result of noncompetitive industry support in Australia, it is unlikely that the remaining manufacturers would benefit as the outgoing manufacturer may simply import the vehicles from other plants it has elsewhere in the world in order maintain Australian market share. Whilst some of the production may be picked up by local producers this would not be significant enough to ensure critical mass. As a result, demand for locally produced components would be reduced leading to price rises that would compromise the competitiveness of the remaining Australian vehicle manufacturers.
- 4.7 As a consequence of an increasingly competitive market, the industry itself will continue to respond to the need to constantly improve its own performance. However, it cannot do this in isolation from the industry operating environment. The policy settings adopted for the post 2005 period will substantively impact upon the attractiveness of the automotive investment environment in Australia. In a world of highly mobile investment capital, having an internationally competitive policy environment is vital if the industry is to achieve the strong future growth that will allow the industry to continue to act as a driver of Victorian, and Australian, economic growth and prosperity within the knowledge economy.

Market access

- 4.8 According to 'Benchmarking the Automotive Industry Policy Environment' Report, Australia is one of the most open economies in the world with import penetration rates at 58.9 percent of the total market. In comparison Germany has 47 percent and the US 34 percent.⁸ This high level of imports indicates the distinctive openness of the Australian economy to import penetration.
- 4.9 Unfortunately however, Australian producers do not have the comparable access to international markets. In order for Australian producers to maintain viable production levels, access to new markets must increase. As stated earlier, the limited nature of potential domestic market share means that growth can only be derived through an increase in exports.

A constructive and collaborative labour market approach

- 4.10 The Victorian Government recognises the importance of a productive industrial relations environment as well as the substantial cost to industry parties of industrial disputations, the significant and rapid economic impact of such disruptions, and the potential damage to the reputation of the industry. A focus of employer submissions to the Inquiry is the

⁸ The Allen Consulting Group and Deloitte Touche Tohmatsu, *Benchmarking the Automotive Industry Policy Environment*, A Report to the Federal Chamber of Automotive Industries and the Federation of Automotive products Manufacturers, 26 February 2002.

particular vulnerability of the automotive industry to supply chain disruption, and the consequent magnified effect that disputes confined to a single enterprise can have on the continuity of production and employment throughout the industry.

- 4.11 Consequently, the Victorian Government believes that industry stakeholders should explore the feasibility of some special industrial arrangements to avoid or minimise the impact of disputation. However, this needs to recognise the rights which parties have under the Commonwealth Workplace Relations Act that allow parties to take protected industrial actions in the course of enterprise bargaining, and the diminished role for the Australian Industrial Relations Commission in the resolution of industrial disputes.
- 4.12 The Victorian Government is aware that some industry parties, including both the Australian Industry Group and AMWU, have called for a dialogue on a range of industry-level issues in their submissions to the inquiry and recent public statements. The Victorian Government would support these parties engaging in such dialogue, and would be prepared to play an appropriate role in facilitating such a process. However, for any dialogue to be productive, the parties need to develop clear understandings about the scope of issues being discussed, and to have ownership of any outcomes. The Victorian Government notes that there is a provision in the Workplace Relations Act that encourages the operation of consultative arrangements at the industry level, with a role for the Australian Industrial Relations Commission in establishing and facilitating such arrangements. This may be a worthwhile option for the parties to consider.
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Concerns about the Productivity Commission Position Paper

Key Concerns

- 5.1 The Victorian Government supports the Commonwealth Government's desire for a viable, internationally competitive and globally integrated automotive manufacturing sector in Australia.
 - 5.2 Future policy settings should be designed to achieve this outcome without being detrimental to the longer term interests of the broader community. This outcome is best achieved by policy settings that facilitate further growth within the automotive industry. Such growth would be associated with continued gains in industry productivity, vehicle quality, export sales and knowledge spillovers for the wider economy.
 - 5.3 The Victorian Government has six major areas of policy concern with the Productivity Commission's Position Paper:
 - Despite the Productivity Commission's modelling concluding that there is negligible benefit to the Australian economy and net economic welfare losses to the Victorian and South Australian economies, it recommends progressive withdrawal of industry support.
 - It does not identify the policies necessary to encourage a competitive innovation based industry.
 - It asserts that a unilateral decrease in tariffs and industry support will bring benefits to the automotive industry and the Australian economy regardless as to whether foreign markets liberalise or further tighten their markets.
 - It underestimates the importance and uniqueness of the spillover economic benefits associated with the activities of the Australian automotive industry.
 - It inadequately addresses the economic impact on regional Australia.
 - It presents an unduly negative view of the industrial relations environment in the industry and makes some preliminary findings which do not appear to be based on appropriate research or evidence.
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- 5.4 Before expanding on each of these key concerns, it is worth noting that the Productivity Commission implies that the ‘cost’ to taxpayers of current industry support arrangements would be removed by reducing the tariff and ACIS support (p.125). However, ACIS assistance is delivered in the form of forgone tariff duty received by the Commonwealth Government. The reduction in total duty received from vehicles and components would be greater under the suggested 5 percent tariff and no ACIS scenario than under the 2005 situation of a 10 percent tariff with ACIS. Therefore, when the net impact on the budget (the ‘cost’ to taxpayers) of the industry support arrangements that will be in place in 2005 is compared to the net impact on the budget of the Commission’s proposed position in 2015 of 5 per cent tariffs and no ACIS, it becomes clear that reducing both tariffs and ACIS actually ‘costs’ the taxpayer more than maintaining them at 2005 levels.

Modelling

- 5.5 The Commission’s analysis demonstrates that reducing industry assistance further after 2005 would generate insignificant benefits for the Australian community. The Commission also acknowledges that reducing industry support post 2005 would restrict the industry’s future growth.
- 5.6 The Commission’s own in-house MONASH modelling indicates that reductions in automotive assistance would result in ‘negligible impacts on household income’ and ‘similarly inconsequential impacts for the wider economy’ (page 110). Inexplicably, the Commission still suggests that automotive industry support should be unilaterally reduced and eventually removed by 2015.
- 5.7 In support of this recommendation that assistance should unilaterally be further phased down after 2005, the Commission relies upon the claim that such reductions would bring ‘dynamic’ benefits of ‘unknown’ nature and quantum to the economy.
- 5.8 The Victorian Government has concerns with some of the assumptions used by the Commission in its modelling. It believes that these have resulted in it overestimating net allocative efficiency gains that would flow from tariff reductions below 10 per cent and underestimating the extent of adjustment costs that would be imposed on the economy due to reductions in tariffs and the eventual removal of ACIS. In particular:
- There is significant international evidence to suggest that the use of an export elasticity of demand of -10 is inappropriate. The use of such a high elasticity substantially exaggerates any growth in Australian exports that would flow from a reduction in assistance to the automotive industry. The Centre of Policy Studies at Monash University, which developed the MONASH model, has analysed this issue in depth and now favours an elasticity of around -3 or -4 .
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- The Commission's modelling assumed that aggregate employment would remain unchanged, therefore negating adjustment costs likely to occur as a result of a reduction in industry support.
- While the Commission relies on an assertion of unspecified dynamic benefits that would flow from reductions in assistance, it does not attempt to analyse the adjustment costs that may result from such a policy. These costs could be very substantial, particularly if one manufacturer, that has significant presence in a regional centre, left the industry.
- The modelling fails to acknowledge that if the level of activity in the industry declined as a consequence of reductions in assistance, the competitiveness of the assemblers would decline. This is because reduced overall industry scale would lead to increased unit costs, particularly in component production. This, in turn, may adversely affect the competitiveness of vehicle producers.

5.9 The Victorian Government has engaged the Centre of Policy Studies to remodel the Commission's policy scenarios using more realistic assumptions regarding export elasticities, impacts of scale on the components industry and employment related adjustment costs. The results of this modelling will be released as soon as it is available in late August.

Policies to achieve a competitive innovation industry

5.10 Whilst acknowledging the automotive industry exists in a fiercely competitive international environment where a range of policies exist to attract investment, the Position Paper fails to recognise the importance of an internationally competitive policy environment in attracting investment to Australia. The Victorian Government believes Australian industry support policies must be competitive with industry support schemes in other jurisdictions. Consequently, work is currently being undertaken by the Victorian Government to develop more detailed policy suggestions on how this may be achieved.

Unilateral decreases in industry support

5.11 The Victorian Government accepts the Commission's view that 'Australia must determine its assistance policies on the basis of what is in its own best interests, rather than being hostage to what other countries choose to do.' (page 117). However, it should be recognised that the development of a competitive industry assistance scheme *in Australia's own best interests* requires the adoption of an international perspective. Policy recommendations based on unilateral analysis or free trade ideology risk ignoring the profound challenges and competition of the global environment in which we seek to participate.

- 5.12 The Commonwealth Government must ensure that it does not repeat the same error in policy settings that resulted from the last inquiry. It was assumed that by 2005 there would be benefits to the automotive industry as a result of taxation reforms, microeconomic reforms, labour market reforms and substantially improved export market access which collectively would allow the industry to adjust to a further cut in tariffs. The commitment to an automatic reduction of tariffs from 15 to 10 percent from 1 July 2005 arguably removed the pressure from Governments to deliver on these reforms.
- 5.13 The Victorian Government strongly rejects any notion of unilaterally 'locking in' future tariff reductions. The Victorian Government considers that there should be a check on the progress of the Australian and foreign Governments' performance on reforms before tariffs are lowered in the future.
- 5.15 The fierce competition for globally mobile automotive investment capital must be factored into any industry support deliberations. Linking any reductions in assistance to the Australian automotive industry to changes in the international policy environment is necessary if Australia is to retain and grow this strategically important industry. Only if policy settings in Australia are internationally competitive will the automotive industry have the opportunity to succeed in the global market.
- 5.16 Having an internationally competitive automotive industry should be interpreted to mean having an industry that can compete globally with assistance arrangements similar in effect to those in place throughout the global industry.
- 5.17 The fact that leading and emerging automotive producing countries provide special assistance to their automotive industries (above the level available to most other manufacturing industries) reflects the fact that they judge that the industry delivers special benefits over and above those associated with other industries. The unusually large spillover benefits associated with the automotive industry are considered below.

Spillovers

- 5.18 The Productivity Commission acknowledges the positive spillover effects to the broader economy. It qualifies this statement however, claiming that these spillover effects are not unique to the automotive industry as other industries can also play this role. Such industries would include:
- advanced materials;
 - microelectronics;
 - advanced electronics;
 - information equipment;
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- biochemicals; and
 - medical and scientific equipment.
- 5.19 However, these are industries in which, in the main, Australia has relatively limited capabilities. The reality is that the motor vehicle industry is one of Australia's few manufacturing industries that operates on a sufficient scale to contribute significantly to the development of a knowledge driven economy.
- 5.20 Like other countries around the world, Australia is formulating policy and initiating infrastructure to attract industries that exhibit innovation, technology and global integration. The Victorian Government believes that these benefits are currently being produced by the automotive industry in Australia which is why the Victorian Government has been active in the past in supporting major automotive investment in the State.
- 5.21 Whilst other Australian industries also have cross-sectional linkages, the automotive sector is one of the internationally sought after industries where the linkages are inextricably associated with a high levels of R&D, innovation and capability building. More important, though, is the spillover effect created through this leading position.
- 5.22 These outcomes are consistent with current Commonwealth and Victorian industry policies that emphasise the importance of innovation and technology in the development of a knowledge based economy.
- 5.23 In the absence of any other significant advanced manufacturing industries in Australia, the automotive industry stands alone in its ability to delivery the powerful spillover benefits that such knowledge intensive and globally oriented industries bring.

Regional economies

- 5.24 The Australian automotive industry including the components manufacturers, is a significant and substantial contributor to Australia's regional economies, particularly in Victoria, South Australia and New South Wales.
- 5.25 This significance is demonstrated by the following: Ford in Geelong (2,190 employees), Automotive Components Limited in Launceston, Tasmania (480 employees), Schefenacker Lighting Systems Australia in Taree, NSW (350 employees), BTR Automotive in Albury, NSW (840 employees) Empire Rubber in Bendigo, Victoria (450 employees) and Toowoomba Foundry in Toowoomba, Queensland (230 employees). These component manufacturers are of considerable importance to the viability and sustainability of the regional centres in which they are located.
- 5.26 Work conducted by the National Institute for Economic and Industry Research (NIEIR) for the Victorian Manufacturing Industry Consultative Council (MICC) has modelled the percentage change in the Victorian regional Gross Regional
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Product using two scenarios.⁹ The results for the most affected local Government areas are illustrated in the table below.

- 5.27 The first scenario indicates the impact of the elimination of ACIS and tariffs remaining at 10 percent. The second scenario models the Productivity Commission's 'preferred tariff option' of a 10 percent tariff between 2005 and 2010 with a reduction to 5 percent in 2010 combined with the Productivity Commission's 'third ACIS option' of ACIS maintained at the current level to 2010 and then halved in 2015.

Table 1. Percentage Change in Victorian GRP

Local Government Area	Scenario 1	Scenario 2
Hobsons Bay	-19.8	-7.2
Hume	-14.5	-5.3
Geelong *	-13.2	-4.8
Maroondah	- 6.3	-2.3
Glen Eira	- 6.1	-2.4
Greater Dandenong	- 5.6	- 2.0
Ballarat *	- 3.2	- 1.2
Wodonga *	- 0.7	- 0.3
Bendigo *	- 0.6	- 0.2
Total Victoria	- 2.2	- 0.8

* Indicate Regional areas

- 5.28 Under both scenario 1 and 2, a large proportion of Victorian local Government areas would experience a significant decline in GRP. Of particular concern are the predicted impacts on regional economies of Geelong, Ballarat, Bendigo and Wodonga.
- 5.29 In the Position Paper, the Productivity Commission has acknowledged the significant adjustment impacts on regional Australia. In its previous report entitled, *Structural Adjustment – Key Policy Issues*, the Productivity Commission also highlighted the need for policies and programs to assist regions and communities to adapt to the significant structural changes. The Position Paper however, is silent on the specific measures to assist affected workers or regions.

⁹ The National Institute of Economic and Industry Research, *Motor vehicle industry assistance: Implications for the industry and the Victorian economy*, July 2002.

It is important that the final recommendations of the Productivity Commission provide advice to the Federal Government on how best to minimise the adverse affects of changes to assistance arrangements, including the adjustment costs incurred as a result of the tariff reduction from 15 to 10 percent in 2005.

Workplace Arrangements and Industrial Relations

- 5.30 The Commission has given some limited acknowledgement to the progress which the industry has made in improving the industrial relations environment and productivity performance of the industry. The Victorian Government considers that stronger recognition of this transformation should be given, not just as a matter of historical record, but as a pointer to the potential for the partnership of employers, employees and their unions to deliver further on high performance enterprises through cooperative workplace culture.
- 5.31 The preliminary findings, relating to union coverage and legislative change, do not appear to be based on an adequate investigation by the Commission. The Victorian Government does not believe that the proposed legislative measures to alter the statutory bargaining framework will make any positive contribution to the industrial relations environment, and may well be counterproductive. The Victorian Government welcomes the Commission's encouragement of dialogue between the industrial parties on appropriate issues at the industry level.
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The Victorian Government Policy Position

- 6.1 The critical success factors for the continued success of the Australian automotive industry are:
- An environment that fosters innovation;
 - A predictable, stable, internationally competitive investment environment;
 - Improved export market access; and
 - A constructive, collaborative labour market.
- 6.2 Given the critical success factors above form the objectives of the Victorian Government's policy position the Victorian Government believes that specific policy priorities should be to:

Build a stable and internationally competitive investment environment

A package broadly similar to the current ACIS scheme must be maintained for at least the next five years.

Provide certainty on tariff levels

Tariffs on passenger motor vehicles must be maintained tariffs at 10 per cent until at least 2010. After this date, tariffs should continue to remain at 10 per cent unless there are substantive reductions in automotive tariff and non-tariff barriers by other countries.

Improve export market access

Improved market access should be pursued through bilateral and multilateral negotiations. Effective negotiations provide valuable means of gaining access to new markets, particularly within the Asian region.

Encourage further industry investment in innovation

In addition to ACIS, the general support measures for R&D should be reviewed within five years to ensure that there is access to appropriate general support for R&D activities undertaken in the automotive sector.

Encourage a collaborative workplace environment

All key stakeholders in the automotive industry, including Governments at all levels, must make it a priority to develop a collaborative – rather than adversarial – process of managing industrial disputes that has at its core the commitment to protect and nurture the highly-tuned industry supply chains.

- 6.3 It must also be acknowledged that the Commission's own modelling shows the unilateral phase down of tariffs to 5 per cent and the eventual removal of ACIS would not generate any significant overall benefits for the Australian economy. It is clear however, that the above policy settings supporting the automotive industry would generate significant benefits to the automotive sector and foster important spillovers to the broader economy.
- 6.4 Therefore, the growth of the automotive industry will bring powerful benefits to regional, state and the national economy as we compete in an increasingly knowledge intensive and globally integrated economy. Supporting this growth does not entail imposing an overall cost on the wider community. The Victorian Government strongly suggests that the Commission reconsider its policy options to give greater emphasis on policy settings that would best support the further development of a viable, internationally competitive and globally integrated automotive industry.
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